By *Loughlin F. McHugh* ☆

Current Financial Position of Corporations

AFTER 5 years of high and generally expanding operations, corporations were in a favorable financial condition at the end of 1950. Since the end of the last war, current assets have expanded by over $50 billion or about 50 percent, while current liabilities have risen about $27 billion. Thus net working capital—current assets less current liabilities—amounted to $75 billion at the end of 1950 as compared with $50 billion at the end of World War II and $25 billion before the start of the war in 1939.

At the end of 1950 corporate holdings of cash and United States Government securities were the highest on record, about $3 billion above the previous peak reached at the end of World War II. Even after allowing for the fact that part of the most recent gains in liquid asset holdings was associated with Federal tax increases, it appears that the current liquidity of business compares favorably with that of prosperous peacetime years in the past, and on an over-all basis was surpassed only during the war years when Government fiscal policies combined with wartime restrictions on private investment to bring about an abnormally high liquid position.

The currently advantageous financial position of business has been achieved in a period which witnessed a private capital expansion program surpassing any previously recorded for a comparable interval of time and involving the expansion of working as well as fixed capital. On the average, the annual investment or uses of funds by corporations in the postwar period, both on capital and current account, amounted to $25 billion, with a new peak of $37 billion being reached in the year just passed. These figures stand in contrast to the total disposition or uses of funds by corporations amounting to about $18 billion in 1941, a year of substantial defense preparations, and an average of around $10 billion in the prosperous period of the late 1920's. The higher level of prices currently accounts for only part of the increased uses of funds as compared to the prewar periods.

The principal factor in the financing of this huge postwar program has been the maintenance of high profits which, combined with generally conservative dividend payments by corporations, resulted in a volume of retained earnings equal to two-fifths of the total postwar capital requirements. Together with funds allocated to depreciation reserves, these internal sources made up roughly two-thirds of total uses of corporate funds.

The postwar capital expansion of business was associated with a substantial increase in external financing, particularly in corporate indebtedness. The downward trend in long-term corporate debt which has persisted throughout the depression and war periods was reversed in 1946, and in the succeeding 5 years long-term debt rose about $20 billion or fifty percent about 1945 levels. The increase in short-term bank indebtedness amounted to about $7 billion in the same period. Despite the substantial expansion of corporate debt, the present indebtedness position of nonfinancial corporations does not appear to be unduly high in the light of other economic considerations such as the profits of corporations as a whole and the low rate of interest.

In relation to the rate of capital expansion, external equity financing was moderate throughout the postwar period, amounting for the years 1946 through 1950 to about $7 billion, or 5 percent of total requirements. However, it appears that the over-all share of equity financing (including retained earnings and stock issues) was about in line with or larger than in previous periods of high peacetime activity.

Viewing the period ahead, it is clear that divergent tendencies will be affecting business financial developments. As pointed out elsewhere in this issue, businessmen expect to spend in 1951 about one-fifth more than in 1950 for new plant and equipment, but there is some question whether as a result private financial requirements will be increased. Undoubtedly fixed capital outlays will be higher than in 1950 for defense and related industries. There is reason to doubt, however, that all of the expected expenditures on facilities for the nondefense areas will be forthcoming in view of the shortages of materials and manpower. Moreover, in the case of essential capital outlays, some of the financing will be undertaken directly or indirectly with the aid of the Government, and hence will not involve any problems of private financing.

Working capital will also be affected by the defense program. While increases may be required in defense-related industries, inventory and credit controls will serve to limit expansion in less essential areas. Consumer credit controls are already in effect and will serve to dampen the direct and indirect extension of credit by corporations to final consumers.

While capital requirements will remain extremely high in the months immediately ahead while the defense program is taking shape, it would appear that the full impact of the defense program may be in the direction of reduced business demand for private funds. At the same time, consumer savings and funds seeking investment outlets will probably tend to increase, thus resulting in a situation similar to the experience of World War II when downward pressures were exerted on the cost of private funds and business was accumulating unprecedented sums in liquid assets.

Postwar Capital Requirements

The current and prospective financial position of corporations may be placed in perspective by examining the general trends of financing over the last 5 years. The data presented in table 1 and charts 1 and 2 trace the use and flow of funds for business corporations other than banks and insurance companies.[1] Additional detail relating to securities market financing is shown in table 2, which presents a broad industry breakdown of net new security issues and net purchases of these securities by banks, insurance companies, foreigners, and domestic individuals.

5-year total uses of $130 billion

As may be seen from table 1, the combined capital expansion program of the postwar period from 1946 to 1950 aggregated over $130 billion. These postwar requirements

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[1] Uses of funds should, of course, equal sources. That they do not do so in table 1 is due to a number of factors, one of the most important of which is errors in estimation. For other factors affecting the discrepancy between sources and uses, as well as for a discussion of the general sources and uses approach, see "Business Financing in the Postwar Period," this SURVEY, March 1948.

far surpassed any previous experience in the private sector of the economy, even if allowance is made for the generally higher prices which have prevailed in recent years.

Plant and equipment outlays by corporations amounted to over $75 billion in this postwar period, or about three-fifths of the total financial requirements. The addition to the net property account, that is, after allowing for depreciation, totaled $48 billion in this period or over two-thirds of the book value of the property account at the end of 1945. The increase in physical capacity was smaller relatively, not only because of the higher prices at which these expenditures were made, but because the book value of the property account understated the real value of facilities.[2] It is doubtful however, that the postwar pace of private facilities expansion —either in dollar terms or in physical volume—has ever been approached in any previous 5-year period.

Next in amount to plant and equipment requirements in the postwar period was the expansion of inventories and customer financing which combined accounted for about $46 billion, or over one-third of the 1946–50 total. The rise in these items reflected both the expanded level of operations and the higher prices which have prevailed in the postwar period. The increase in liquid assets over the whole period was, on the other hand, relatively moderate, as substantial reductions in the early postwar period offset in large part the additions made in later years.

Variability in working capital

A glance at table 1 reveals the sensitivity of business demands for working capital funds to the general business situation. It is generally recognized that expansionary forces were dampened following the boom years 1946–48, and by 1949 recessionary tendencies were in evidence. The drop in current capital requirements in the latter year was much sharper than in most of the other indicators of general business activity. And with the pickup in general business activity in 1950, particularly in the last 6 months, requirements again expanded rapidly.

Table 1.—Sources and Uses of Corporate Funds, 1946–50[1]

[Billions of dollars]

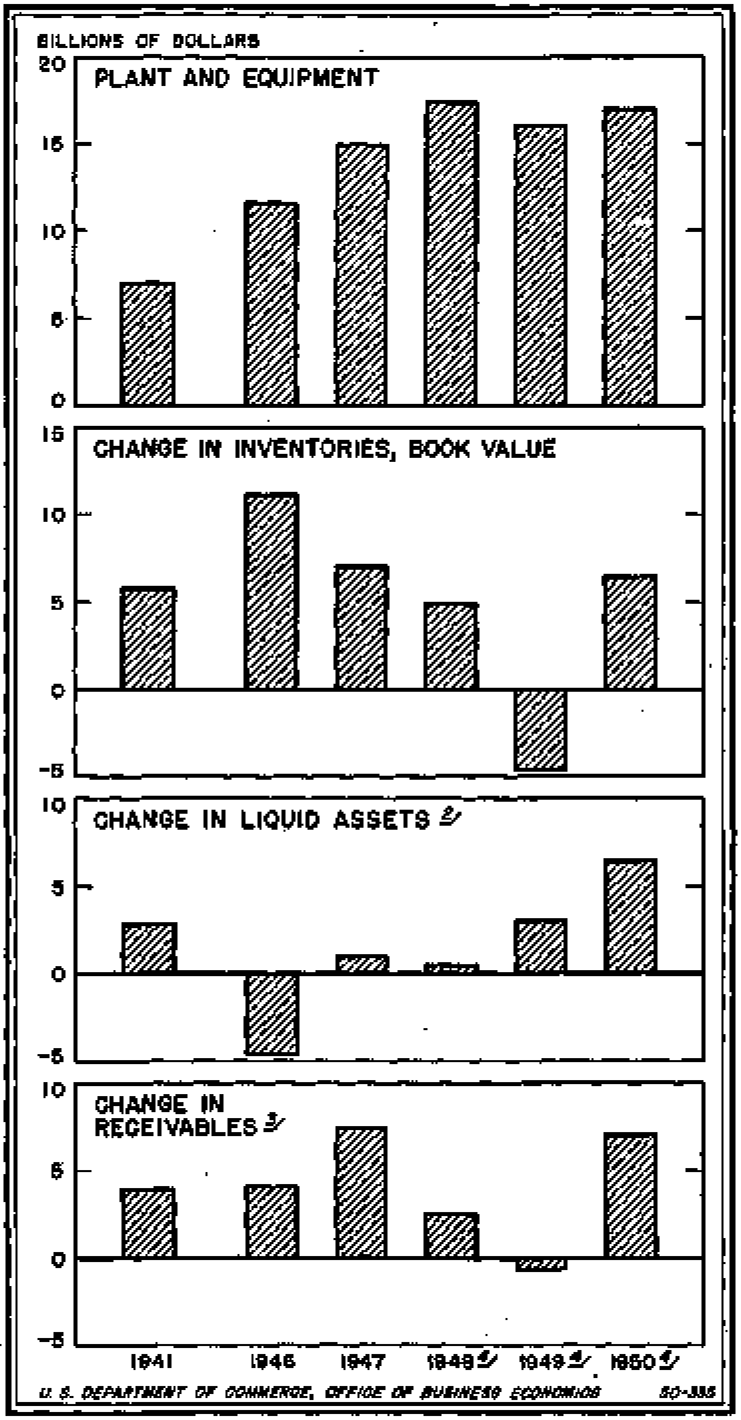
Item	1946	1947	1948[2]	1949[2]	1950[2]
Uses:					
Plant and equipment	11.8	15.0	17.4	16.1	17.0
Inventories (book value)	11.2	7.1	5.0	−4.6	5.5
Receivables	4.8	7.0	2.5	−.5	6.5
From business	5.1	6.0	.9	−2.3	4.5
From consumers	1.7	1.3	1.4	1.4	1.5
From government	−2.0	−.3	.2	.3	.5
Cash and deposits	1.1	2.2	.2	1.0	2.5
U. S. Government securities	−5.8	−1.2	.3	2.0	4.0
Other current assets	−.7	−.1	(4)	−.2	.5
Total	23.2	30.6	26.4	13.8	37.6
Sources:					
Retained profits[4]	7.6	11.0	12.6	8.6	12.5
Depreciation	4.2	5.2	6.0	6.7	7.0
Payables (trade)	4.0	4.4	.8	−2.2	3.5
Federal income tax liability	−1.6	2.3	.6	−2.4	7.0
Other current liabilities	2.1	1.0	(3)	−.1	1.0
Bank loans (excluding mortgage loans)	3.2	2.0	1.1	−1.8	2.5
Short-term	1.9	1.0	.6	−.8	3.0
Long-term	1.4	1.0	.6	−1.1	−.5
Mortgage loans	.6	.8	.6	.7	1.0
Net new issues	2.3	4.4	6.0	5.4	4.0
Stocks	1.3	1.3	1.3	1.0	1.5
Bonds	1.0	3.1	4.7	4.4	2.5
Total	22.6	32.3	28.3	14.9	38.0
Discrepancy	−.6	−1.7	−1.9	−1.1	−.4

[1] Excluding banks and insurance companies.
[2] Preliminary. Estimates for 1950, based on incomplete data, are rounded to the nearest 0.5 billion for the major components. Total sources and uses derived from unrounded figures.
[3] Less than $50,000,000.
[4] Including depletion.

Source: U. S. Department of Commerce based on Securities and Exchange Commission and other financial data.

[2] The understatement is a reflection of the usual conservative accounting practices and of the fact that the Government permitted accelerated depreciation on many war-built facilities.

Chart 1.—Uses of Corporate Funds[1]



[1] Excluding banks and insurance companies.
[2] Includes changes in cash and deposits, and U. S. Government securities.
[3] Includes changes in current assets not shown separately.
[4] Data are preliminary; estimates for 1950 are based upon incomplete data.

Sources of data: U. S. Department of Commerce, Office of Business Economics, based upon Securities and Exchange Commission and other financial data.

Fixed capital expenditures in the postwar period were generally well maintained, expanding steadily through 1948, dipping only moderately in 1949 and again rising in 1950. The maintenance of the high level of fixed capital expenditures in the postwar period reflects, of course, not only the general demand picture but also the substantial backlog of capital goods demand built up during the war. The contrasting experience in long- and short-term postwar investment developments is explainable in terms of the more rapid process by which backlog demands for working capital could be met.

Table 2.—Changes in Corporate Securities Outstanding and in Their Ownership, 1946–50

[Billions of dollars]

Item	1946	1947	1948	1949	1950
Net issues [1] by industry group:					
Industrial and miscellaneous	2.5	2.4	2.0	2.6	1.7
Public utility (and telephone)	.3	2.2	3.0	2.8	2.3
Railroad	−.5	−.1	.2	.2	.2
Net purchases [2] by various groups:					
Banks	.5	.3	(3)	.4	.3
Life insurance companies	2.0	3.2	4.2	2.9	1.8
Foreigners	−.2	−.2	−.2	(3)	(3)
Domestic individuals, etc.	0	1.3	2.0	2.1	2.1

1 New issues less retirements.
2 Purchases less sales.
3 Less than $50 million.

Source: U. S. Department of Commerce estimates based on Securities and Exchange Commission and other financial data.

Corporate holding of liquid assets

Despite the huge capital requirements in the postwar period, corporations generally maintained adequate holdings of cash and United States Government securities. Business corporations entered the postwar period with unusually high liquid resources. With the lifting of wartime restrictions on capital expansion, corporations made use of a portion of these resources to help finance their expanded investment programs. Since 1946, however, sizable additions have been made to both cash and Federal security holdings.

The most striking increase in liquid resources was made this past year as over $6 billion was added to cash and United States Government securities. Most of this increase occurred in the second half of the year and was attributable in part to expanding levels of activity, in part to precautionary measures anticipating future requirements, and in particular to the stepped-up rate of corporate tax liabilities.

More significant than the trend in actual holdings of liquid assets are the changes in these resources in relation to other relevant financial data. A few of the commonly used liquidity ratios are presented in table 3. The higher the ratios shown in the table, the more liquid is the financial position of corporations.

Table 3.—Corporate Liquidity Ratios, Selected Years, 1940–50[1]

Year	Ratio to sales (percent)		Ratio to current liabilities (units)	
	Liquid assets	Liquid assets less Federal income tax liabilities	Liquid assets	Total current assets
1940	11.3	9.3	0.40	1.84
1941	10.0	6.8	.44	1.70
1945	17.9	13.5	.83	2.13
1946	14.1	10.9	.73	2.06
1947	11.2	8.2	.64	2.01
1948	10.3	7.2	.61	2.04
1949	11.7	9.0	.72	2.29
1950	12.2	8.8	.70	2.10

1 Excluding banks and insurance companies. Sales data are total for given period. Other data used to derive ratios are for end of period shown.

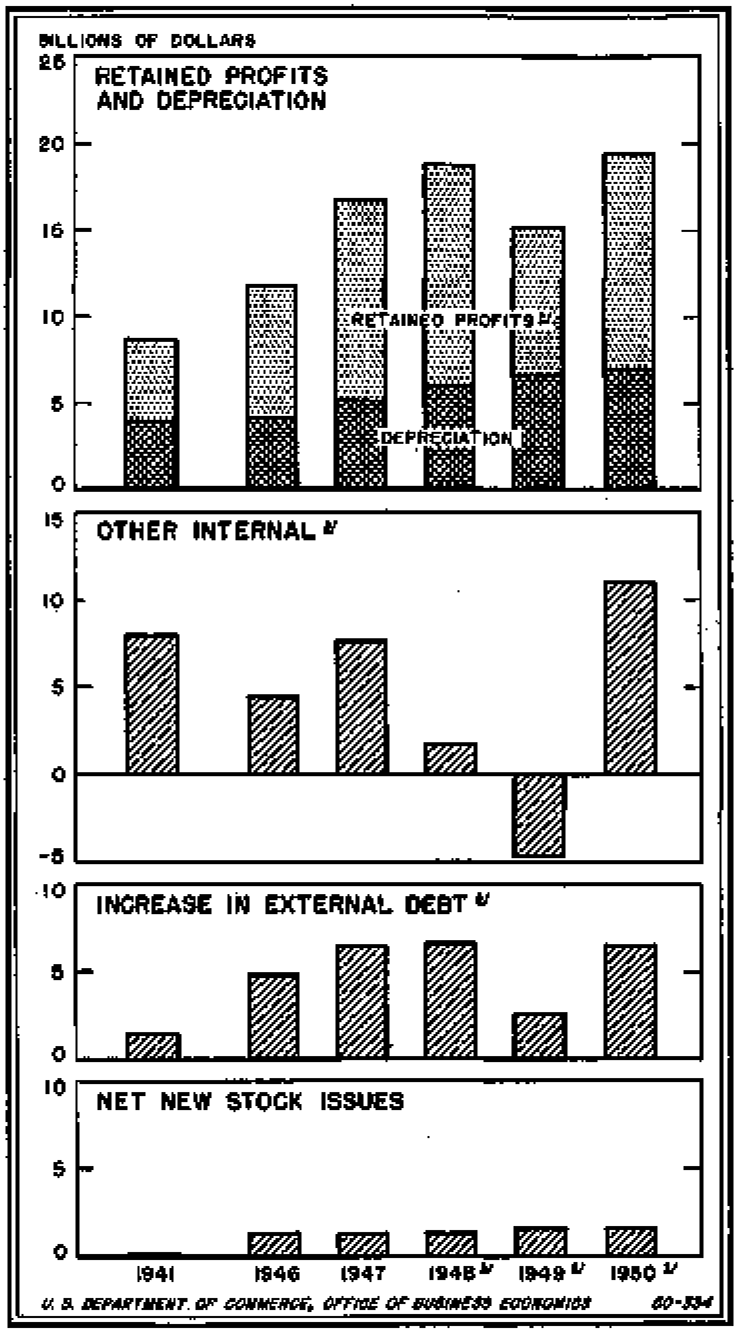
Source: U. S. Department of Commerce, based on data from Securities and Exchange Commission and Bureau of Internal Revenue.

As the table indicates, while the liquid position of business is at present not so favorable generally as at the end of World War II, business liquidity compares quite satisfactorily with most of the peacetime years shown. Total liquid assets held at the end of 1950 constituted about one-eighth of corporate sales for the year, a proportion significantly higher than any peacetime year with the exception of 1946, when corporate liquid resources were still influenced by wartime developments and reconversion to peacetime activity was in its early stages. In the boom years of the late twenties, it may be noted, this ratio ranged around 10 percent.

Only for one of these ratios is the current position of corporations lower than prewar. If Federal income tax liabilities are subtracted from liquid assets and the remainder related to sales, the ratio in 1950 is below 1940 but is greater than 1941, a year of sharply increased Federal taxes.

In making a comparison of liquid resources to sales for the prewar and postwar periods, it might be expected that liquid assets would not need to rise in proportion to the very substantial increase in activity and prices which occurred over this period.

Chart 2.—Sources of Corporate Funds[1]



1 Excluding banks and insurance companies.
2 Includes depletion.
3 Represents net change in current liabilities other than short-term bank loans.
4 Represents net new bond issues and increases in bank loans and mortgage loans.
5 Data are preliminary; estimates for 1950 are based upon incomplete data.

Sources of data: U. S. Department of Commerce, Office of Business Economics, based upon Securities and Exchange Commission and other financial data.

Generally speaking, it appears from these overall measures of liquidity that the liquid position of business is high currently and sufficient to meet a significant part of the financial requirements incident to further expansion of activity. However, many firms obviously will require outside financial assistance to meet the vastly expanded needs of the new defense effort.

Financing Postwar Capital Programs

The following figures summarize the sources of corporate funds for the 5-year period from the end of 1945 through 1950 (in billions of dollars):

Funds retained from operations—total		82
Retained profits	53	
Depreciation	29	
External financing—total		35
Long-term debt	21	
Short-term bank loans	7	
Stock issues	7	
Other financing		20
Total sources		137

Dominance of internal financing

It is clear that internal financing—from funds retained from current operations—constituted by far the dominant means of meeting postwar requirements, being about two and one-half times the total funds obtained from external sources such as banks, other institutional lenders, and the securities markets. In itself this feature is not unusual. In the decade before World War II, the relative use of internal financing was even greater. However, the thirties represented a period in which total investment programs were small by comparison with those of the postwar period.

If the more meaningful comparison is made with the late twenties, it appears that internal financing in those years was less important than in the period following World War II. This latter comparison is the more significant since, in both periods, investment was substantial and was associated with high levels of business activity.

The huge volume of undistributed profits available for post-war expansion reflected in part the favorable profits picture which generally prevailed throughout the postwar period, and in part the conservative dividend policies pursued by corporate business as a whole. Despite the considerable increase in dividends this last year, the proportion of disbursements to profits available for distribution was still below the prewar experience.

It should be noted, however, that a substantial portion of postwar profits is related to inventory gains resulting from rising prices. Even if allowance is made for this influence, it would still be true that retained earnings combined with the other major internal source—depreciation—dominated financing in the postwar period and was relatively more important than in the late twenties when external financing played a more important role.

In view of the temporary nature of inventory profits—they are eliminated when prices cease to rise—corporations may have been inclined to retain a higher proportion of earnings than would otherwise have been deemed desirable. Other possible influences which may help explain the higher postwar share of profits retained in business are increased difficulties or expense in raising equity funds externally, and the much higher level of individual income tax rates in recent years. It may be pointed out that for the larger companies the proportion of earnings paid out in recent years is not much lower than in the twenties.

Record volume of net security issues

Despite the relatively high proportion of internal financing, corporations sold a substantial volume of net new security issues in the postwar period, the average annual total of $4.5 billion being probably the largest in history, if investment company issues are excluded. It is estimated that net of retirements and excluding sales by investment companies, new issues amounted to about $2.5 billion a year in the late 1920's. This is far short of the total volume of new issues in that period, since total sales included not only new money issues but issues for refinancing and retirement of outstanding securities. For the 1930's as a whole and throughout the war period, there was a net retirement of corporate securities.

In making the comparison with the 1920's it should be noted that a large volume of investment company issues was sold in that period, whereas those securities have been relatively minor in the period since the end of 1945.

Of the $22 billion of net new issues sold in the securities markets in the last 5 years, about one-third represented net issues of stock. Although a comparable continuous series extending back to the twenties is not currently available, it is possible from data compiled by the Commercial and Financial Chronicle to note the long-term trends of stock and debt financing in the securities markets. These data are shown in table 4 and in chart 3. In three of the five postwar years (1946, 1947, and 1950) stock financing, exclusive of investment company issues, was as important relative

Table 4.—Relation of Stock Issues to Total Amount of New Capital Issues, by Industry Groups, 1919–50[1]

[Totals in millions of dollars]

Year	All corporations[2]		Industrial and miscellaneous		Public utilities[3]		Railroads	
	Total new issues	Stocks as percent of total	Total new issues	Stocks as percent of total	Total new issues	Stocks as percent of total	Total new issues	Stocks as percent of total
1919	2,808	63.2	1,007	74.5	278	12.5	117	0
1920	2,710	38.2	2,006	40.0	382	34.4	322	0
1921	1,822	14.7	978	15.4	492	23.8	363	0
1922	2,330	24.0	1,086	24.9	720	38.0	524	5.3
1923	2,702	24.4	1,850	23.3	838	28.2	405	4.8
1924	3,322	25.0	1,217	22.8	1,330	37.2	780	7.2
1925	4,080	30.4	2,224	31.3	1,461	34.3	380	4.3
1926	4,280	30.3	2,342	38.4	1,598	28.1	340	11.8
1927	5,210	37.2	2,445	31.6	2,085	37.4	600	18.0
1928	5,293	45.0	3,117	63.5	1,811	41.8	394	14.0
1929	5,417	62.1	3,939	66.5	1,932	63.6	547	24.3
1930	4,712	30.4	1,649	39.0	2,305	32.2	797	5.3
1931	1,760	17.5	466	11.6	949	26.7	340	0
1932	324	6.8	37	32.4	274	2.3	13	0
1933	160	74.4	113	96.1	34	20.6	12	0
1934	160	31.4	37	91.0	49	[illegible]	73	0
1935	403	17.2	248	27.3	83	2.4	73	0
1936	1,209	29.6	811	43.3	124	2.7	267	0
1937	1,225	33.3	840	47.7	163	3.9	223	0
1938	809	7.0	580	10.5	273	1.8	18	0
1939	381	25.5	235	38.7	61	8.2	85	0
1940	735	18.4	323	33.2	208	10.4	144	0
1941	1,062	10.3	411	36.8	309	0.4	262	0
1942	652	18.0	433	19.2	167	21.7	53	0
1943	378	24.3	298	20.0	18	11.4	61	0
1944	663	32.3	437	30.2	46	47.0	68	0
1945	1,264	52.0	1,020	64.5	113	23.2	123	4.1
1946	3,646	41.4	2,483	51.3	818	17.6	120	0
1947	4,828	25.5	2,553	37.1	2,035	14.0	240	0
1948	6,248	14.4	2,784	18.8	2,886	13.1	579	0
1949	4,901	19.4	1,914	12.7	2,537	27.8	450	0
1950[4]	3,860	20.4	1,257	32.1	2,106	32.1	307	0

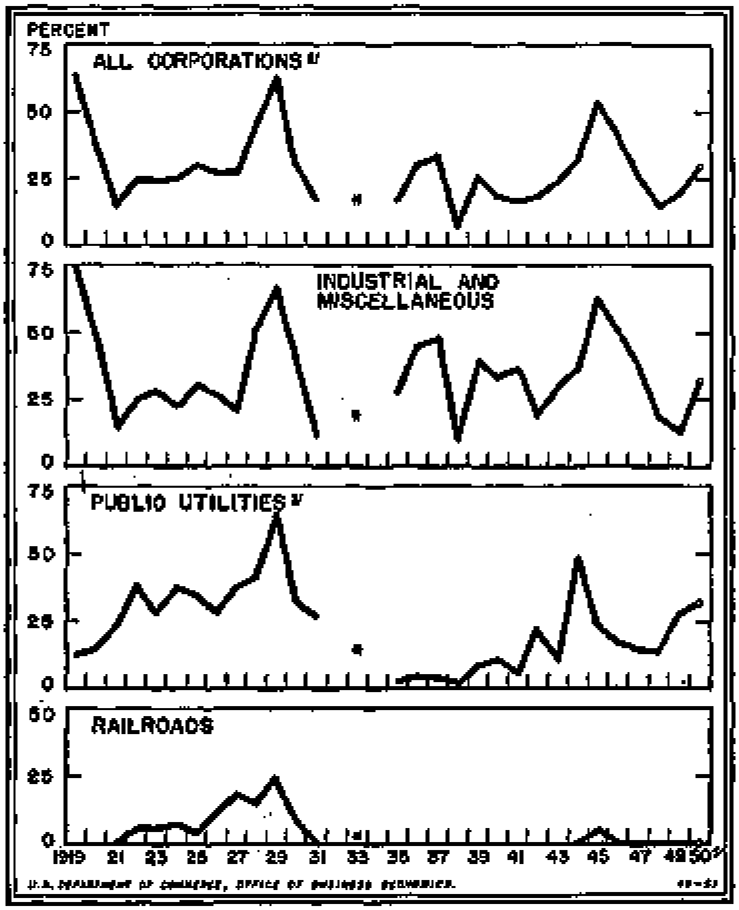
[1] New Capital Issues include issues for the purchase of existing assets.
[2] Excluding investment and holding companies subsequent to 1928.
[3] Including communications.
[4] Figures for 1950 are for the first 10 months.

Source: Commercial and Financial Chronicle.

to the total new capital issues as in the middle 1920's, but considerably below the ratios for 1928 and 1929. However, in the heavy financing of 1948 and 1949, the proportion of stock issues fell well below the rate in the 1920's. It is interesting to note that outside equity financing by utilities—principally gas and electric companies—was increased considerably this past year, reaching on a relative basis a point comparable with such financing in the middle twenties.

Generally speaking, for the first 10 months of 1950 for which data are now available, the relative share of equity to total financing in the securities market compared favorably with the prosperous years of the 1920's with the exception of 1928 and 1929. In the latter year stocks were issued in volume not only for new money purposes but also to refund indebtedness and to acquire existing assets.

Chart 3.—Stock Issues as a Percentage of Total Amount of New Capital Issues, All Corporations and by Industry Groups[1]



*Ratios omitted in 1932, 1933, and 1934, because of the extremely low volume of new capital issues.
[1] Includes issues for the purchase of existing assets.
[2] Excludes investment and holding companies subsequent to 1934.
[3] Includes communications.
[4] Ratios are based upon data for 10 months.

Source of data: Commercial and Financial Chronicle.

However, if account is taken of equity financing in the form of retention of earnings as well as the issuing of new stock, the situation in recent years compares favorably even with 1929 in view of the relatively high proportion of undistributed profits in the postwar period. For the 30-month period preceding the outbreak of Korean hostilities, retained earnings combined with stock issues equaled roughly the same proportion of total requirements as in 1929.[3]

While the share of both external and internal equity financing dropped considerably in the latter part of 1950, the reduction was for the most part a reflection of such special influences as the very sharp expansion of total capital requirements, the increase in Federal taxes and unsettled conditions affected the equity markets in the period immediately following the outbreak of war in Korea.

External debt increased

As indicated above, increasing long-term debt was an outstanding feature of the external financing of business corporations in the postwar period. This debt rose steadily and was composed principally of new long-term bond issues sold through the securities market. Net bond issues, averaging about $3 billion a year from 1946 to 1950, reached a peak of almost $5 billion in 1948 and then declined to about $2.5 billion in 1950.

The increase in bank borrowing was also of considerable importance in corporate postwar financing, rising at a record pace in both the early upsurge of 1946 and in the latter part of last year. Each of these periods was characterized by increasing prices and rapidly expanding working capital requirements.

Despite the substantial postwar increase in corporate external indebtedness, the current level does not appear to be unduly high when considered in the light of previous experience and compared with other financial data. During the war period, corporations were able to reduce their outstanding debt. Moreover the 6 percent or higher interest rates which prevailed up to the period of the 1930's were steadily reduced during that decade and throughout the war period. As a result a large volume of refunding occurred on relatively low interest terms. With the same general pattern of low interest rates prevailing during the postwar period, corporate interest payments continued well below the level of the late twenties despite an increase in corporate debt since that time.

The indebtedness picture is even more favorable when viewed in relation to the generally high level of profits which prevailed in the postwar period. When interest payments are related to profits before taxes and interest, the postwar ratios vary between 7 and 9 percent as compared with proportions of 30 percent in 1929 and 20 percent in 1940.

Manufacturing Sources and Uses

Thus far the review of postwar financing has concerned all nonfinancial corporations. Sources and uses data are shown in table 5 relating to manufacturing corporations only. As may be seen in comparing this table with table 1, the over-all pattern of capital expansion and its financing reflected in large part the course of developments for manufacturing corporations. Requirements for these corporations accounted for over $60 billion or over two-fifths of the total for all nonfinancial corporations in the postwar period. Variations among the component uses of funds closely paralleled the over-all changes, with fixed capital requirements expanding steadily over the period, while the major variations in demands for funds occurred in working capital needs.

In this latter connection, it is interesting to note that while the trend of net working capital (current assets less current liabilities) of manufacturers was steadily upward through the postwar period, net working capital of railroads and electric and gas utilities declined moderately but fairly steadily until 1950, as these latter industries drew on their liquid resources to finance their fixed capital expansion programs. In contrast, manufacturing corporations, after drawing down their cash and United States Government securities in 1946, added steadily to these resources in the following years, with the result that by the end of 1950, liquid assets held surpassed their peak wartime levels.[4]

Manufacturing corporations depended to an even lesser extent than industry generally on external financing. Bank

[3] These generalizations would not be greatly changed if account were taken of inventory profits in the periods compared, although the ratio in the last half of 1950 would fall short of the 1929 figure after such an adjustment.

[4] Even in 1946 when manufacturing corporations reduced their liquid asset holdings, net working capital was increased.

loans constituted only 1 percent of total requirements compared with 6 percent for all corporations, and net new issues represented less than 10 percent of total uses in contrast to a proportion of one-sixth for all groups combined. Of particular note is the relatively minor extent to which these corporations resorted to the securities market in the most recent period. Total net new issues amounted to only about $700 million in 1950 or 3 percent of total requirements.

Table 5.—Sources and Uses of Corporate Funds of Manufacturing Corporations, 1946–50

[Billions of dollars]

Item	1946	1947	1948 [1]	1949 [1]	1950 [1]
Uses:					
Plant and equipment	6.4	7.5	8.1	6.7	7.6
Inventories	6.3	4.3	3.4	−3.3	4.6
Receivables	.1	2.7	.0	−1.0	4.0
Cash	−.2	.0	.2	.7	2.0
U. S. Government Securities	−3.8	−.1	.2	2.1	2.6
Other current assets	−.2	(2)	(2)	−.3	(2)
Total	8.6	16.3	12.9	5.0	20.6
Retained earnings [3]	4.3	7.2	7.8	5.0	8.5
Depreciation	1.9	2.4	2.8	3.2	3.5
Payables (trade)	.8	1.8	.3	−.2	3.0
Federal income tax liability	−1.3	1.7	.3	−1.5	3.5
Other current liabilities	.2	.2	.2	(2)	1.0
Bank loans	.9	.9	.8	−1.7	.5
Mortgage loans	−.1	(2)	(2)	(2)	(2)
Net new issues	1.0	1.6	1.6	.7	.7
Total	9.7	15.7	13.8	5.0	20.6
Discrepancy	−.8	−.6	−.9		

[1] Preliminary. Estimates for 1950 based on incomplete data and rounded to the nearest $.5 billion.
[2] Less than $50 million.
[3] Including depletion.

Source: U. S. Department of Commerce based on Securities and Exchange Commission and other financial data.

Bond Yields Versus Stock Yields

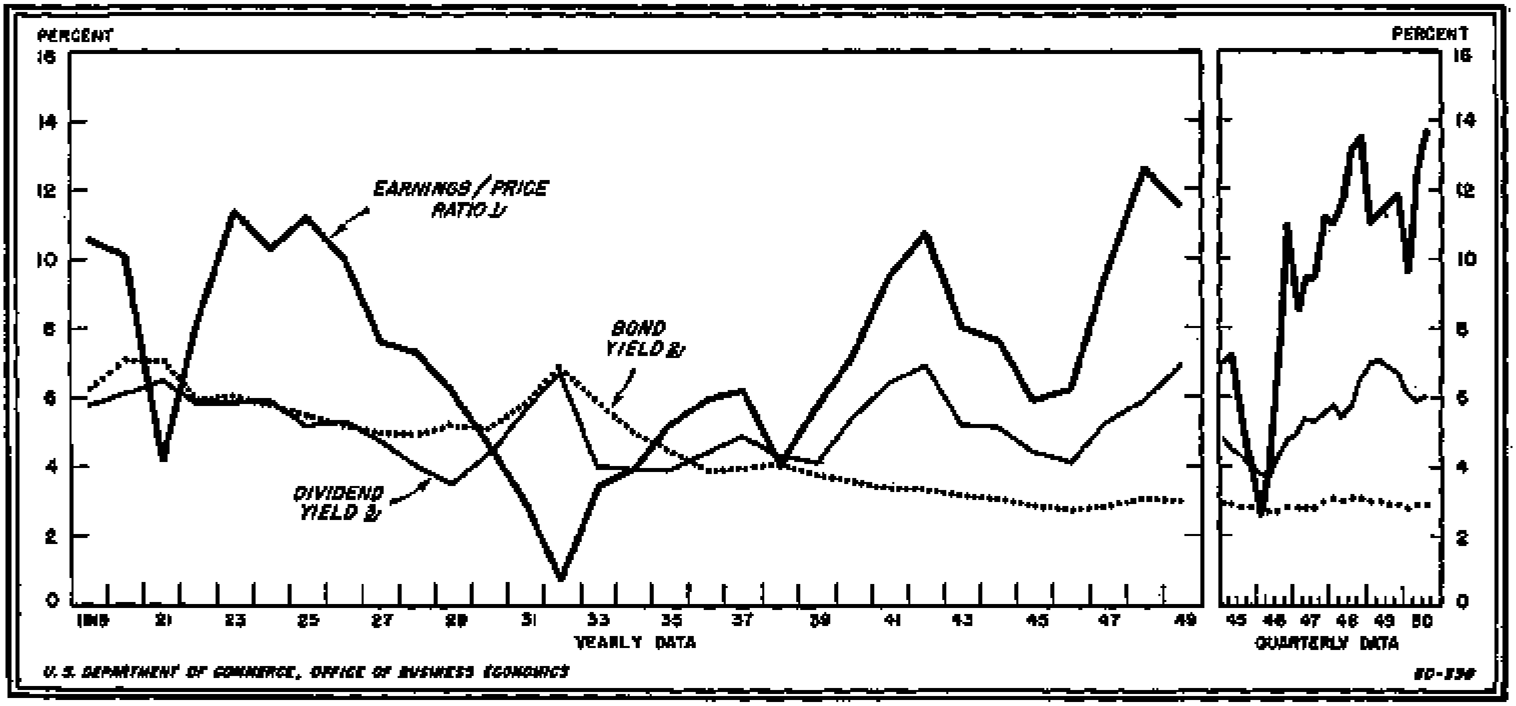
A factor of considerable importance in determining the form which external financing takes is the relative cost of debt and equity financing. The general pattern of variations in these costs is shown in chart 4 and table 6 which present long term series of corporate bond yields and the earnings-price ratios and dividend yields on common stocks. All series are based on data for the larger corporations, that is, those registered on the New York exchanges, and are different from series relating to all corporations; the latter, however, are not available. For purposes of comparing the relative movements of bond and stock yields the data appear to be fairly adequate.

The striking feature revealed by these statistics is the currently large spread between bond and stock yields. During the middle twenties dividend yields on common stocks and bond yields were of roughly the same order of magnitude, with dividend yields slightly higher than bond yields. Earnings-price ratios generally ranged from about 50 to 100 percent above dividend yields.

The steady downward drift of interest rates during the thirties and the war period brought bond yields from the "6 percent" level which prevailed during the mid-1920's to about 3 percent during the war, a rate which has been generally maintained throughout the postwar period. In contrast, dividend yields and earnings-price ratios have shown no such persistent trend and since 1947 for the most part have been about as high as or higher than in the mid-1920's. At the present time, dividend yields are about double and earnings-price ratios about four times the yield on corporate bonds.

However, in making a comparison of the costs of bond and stock financing, it is important to note that bond yields have to be adjusted for comparison with stock yields to take care

Chart 4.—Corporate Bond and Common Stock Yields, and Earnings/Price Ratios



[1] Based upon data for common stocks listed on the New York Stock Exchange; total reported earnings for the year expressed as a percentage of the total market value (number of shares times average prices) of these stocks.
[2] Data are averages of daily figures.
[3] Based upon data for common stocks listed on the New York Stock Exchange; total dividends for the year expressed as a percentage of the total market value (number of shares times average prices) of these stocks.

Sources of data: Bond yield, Moody's Investors Service; earnings/price ratio and dividend yield through 1936, Common Stock Indexes, Cowles Commission Monograph No. 3 and for the following years extrapolated on the basis of movements shown by Moody's earnings, stock prices, and dividend series.

Table 6.—Relation of Bond and Stock Yields by Industry Groups, 1919–50

[Percent per annum]

Year	Total: Bond yield [1]	Total: Preferred stock yields (high grade)	Common stock: Dividend yield [2]	Common stock: Earnings price—ratio [3]	Industrials: Bond yield	Industrials: Common stock earnings price—ratio [3]	Utilities [4]: Bond yield	Utilities [4]: Common stock earnings price—ratio [3]	Rails: Bond yield	Rails: Common stock earnings price—ratio [3]
1919	6.3	6.3	5.8	10.6	6.2	11.3	6.2	8.0	6.4	9.6
1920	7.1	6.8	6.1	10.1	6.9	12.1	7.3	10.7	7.1	5.8
1921	7.0	6.8	6.5	4.3	7.0	(5)	7.2	12.2	6.9	10.1
1922	6.0	6.1	5.8	8.2	6.0	7.3	4.9	12.3	5.9	8.7
1923	6.0	6.1	5.9	11.4	6.0	10.7	6.6	11.4	6.2	12.6
1924	5.8	6.1	5.0	10.3	5.9	9.4	6.6	10.8	5.9	11.9
1925	5.5	5.9	5.2	11.2	5.6	11.2	6.3	9.6	5.6	12.0
1926	5.2	5.8	5.3	10.9	5.4	9.6	6.1	10.0	5.1	12.2
1927	5.0	5.5	4.8	7.0	5.1	7.2	5.0	8.2	4.8	8.7
1928	4.9	5.1	4.0	7.3	5.1	7.0	4.0	7.2	4.8	9.0
1929	5.2	5.1	3.5	6.2	5.3	6.3	5.1	4.4	5.2	8.6
1930	5.1	5.0	4.3	4.7	5.2	4.5	5.0	4.6	5.0	6.2
1931	5.8	6.0	5.6	3.0	6.1	2.9	5.3	5.1	6.1	1.8
1932	6.9	6.1	6.7	.7	6.7	(5)	6.2	7.2	7.6	(5)
1933	5.9	5.6	4.0	3.4	5.3	3.2	6.2	5.4	6.1	(5)
1934	4.0	5.3	3.8	3.0	4.5	4.2	5.4	5.4	6.0	(5)
1935	4.5	4.6	3.9	5.2	4.0	5.6	4.4	6.8	6.0	(5)
1936	3.9	4.3	4.4	6.9	3.5	6.2	3.9	6.2	4.3	3.8
1937	3.9	4.4	4.9	6.2	3.6	6.6	3.9	6.1	4.8	1.3
1938	4.2	4.3	4.8	3.9	3.5	4.1	3.9	6.3	5.2	(5)
1939	3.8	4.2	4.1	6.7	3.3	5.0	3.5	6.7	4.5	2.6
1940	3.6	4.1	5.4	7.2	3.1	7.6	3.2	7.3	4.3	4.9
1941	3.3	4.1	6.4	9.5	3.0	9.0	3.1	7.9	4.0	15.1
1942	3.3	4.3	6.0	10.7	3.0	8.6	3.1	8.9	4.0	31.4
1943	3.2	4.1	5.2	8.0	2.8	8.6	3.0	7.3	2.0	30.7
1944	3.0	4.0	5.1	7.6	2.8	7.0	3.0	8.7	3.4	12.4
1945	2.9	3.7	4.4	5.9	2.7	5.9	2.9	5.9	3.1	6.6
1946	2.7	3.5	4.1	6.2	2.6	6.0	2.7	6.2	2.9	3.5
1947	2.9	3.6	5.8	9.7	2.7	10.9	2.8	8.1	3.1	8.9
1948	3.1	4.2	6.0	12.6	2.9	13.8	3.0	7.6	3.3	10.9
1949	3.0	4.0	6.9	11.5	2.7	13.2	2.9	7.4	3.2	7.8
1950 (3rd Q.)	2.9	2.9	6.0	13.7	2.7	14.3	2.8	8.0	3.1	10.4

1 Moody's corporate bond yields, averages of daily figures.
2 Total yearly dividends on New York Stock Exchange common stocks as percent of total market value of these stocks, based on average price during year.
3 Total reported earnings on common stock as percent of total current value.
4 Includes Communication.
5 Deficit.

Source: Bond yields are from Moody's Investors Service. Preferred stock yields from Standard & Poor's Corp. Dividend yields and earnings-price ratio through 1938 are from Common Stock Indexes, Cowles Commission Monograph No. 3; subsequent figures are extrapolated on the basis of movements of Moody's earnings, stock prices, and dividend series.

of movements in corporate income taxes. Businessmen do not have to pay corporate taxes on income paid out as interest whereas they do have to pay such taxes on all income earned on equity money. Thus the higher the tax rate, the lower is the relative "cost" of debt financing.[4] Hence, totally apart from other considerations, the increase in tax rates from the 1920's to the present time might be expected to result in a substantial gap between bond and stock financing costs. Even after allowance for this factor, the differential between costs of borrowed and equity funds has been increased over this period.

A major factor in the maintenance of the relatively low level of interest rates which presently prevails has been the vastly increased volume of liquid assets carried over from the war period. Of equal importance has been the direct action of the monetary and fiscal authorities in maintaining the market for United States Government bonds.

This policy, dating back to early World War II, was initiated to facilitate the vast borrowing program required during that period. It again takes on primary significance in view of the huge financing program which may be required in the period ahead.

4 In more exact terms, the expected cost of stock financing (e.g., the ratio of expected earnings after taxes to expected stock prices) should be compared with the interest rate times the complement of the tax rate, rather than with the interest rate alone.

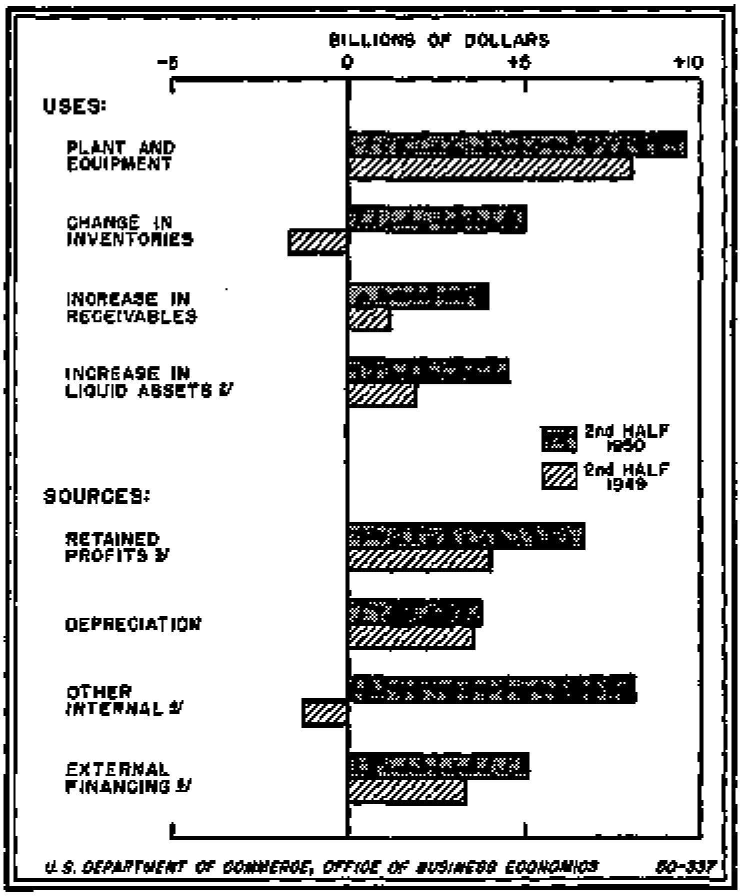
Still another consideration in the maintenance of low interest rates has been the growing institutionalization of savings which places considerable pressure on the finding of investment outlets for the funds of insurance companies, banks and other institutional lenders. These lenders are primarily interested in fixed-interest bearing securities. Life insurance companies alone have bought on balance in the last five years $14 billion of corporate securities, predominantly debt issues, out of total net bond issues of $15 billion (table 2).

At the same time there have been several influences at work tending to maintain relatively high costs of equity financing. There have been indications in recent decades—at least up to the past few months—of a decreased inclination to take risks and a tendency to pay a high premium for security. Another factor has been the increased progressiveness of the personal income tax structure which may also have tended to deter potential equity investors from taking the risks associated with stock investment. Offsetting these influences, in part at least, has been the tendency in the most recent period to increased purchases of corporate stocks by institutional investors, including pension and other funds.

Current Picture and Outlook

In appraising the current financial picture of corporations, attention should be directed to the striking developments in the last half of 1950 when the demand for business funds was accelerated to the highest rate on record (chart 5).

Chart 5.—Uses and Sources of Corporate Funds, Second Half of 1949 and Second Half of 1950 [1]



1 Excluding banks and insurance companies. Estimates for 1950 are based upon incomplete data.
2 Includes changes in cash and deposits, and U. S. Government securities.
3 Includes depletion.
4 Represents net changes in current liabilities other than short-term bank loans.
5 Represents net new securities issues and increases in bank loans and mortgage loans.

Sources of data: U. S. Department of Commerce, Office of Business Economics, based upon Securities and Exchange Commission and other financial data.

For the 6 months following the outbreak of hostilities in Korea, corporate capital requirements totaled $24 billion, or almost three times the uses of funds in the comparable period of 1949. The tempo of demand was stepped up for all major components, but, as in previous years, the increase in working capital requirements was most striking.

The chief sources of funds stemmed from the rapid increase in Federal taxes, higher trade payables and heavy bank borrowing. Because of stepped-up dividend payments and substantially increased corporate profits taxation legislated by Congress since the outbreak of the Korean conflict, retained earnings in the second half of 1950 reflected only moderately the rapid increase in profits which took place since the latter part of 1949. Despite increased tax liabilities, however, the rate of retained earnings in the latter part of 1950 exceeded actual retention of profits in 1948, the prior peak of the postwar period.

Adequacy of capital supply

In view of the rapid surge of business demand for capital since the outbreak of the Korean conflict, there may be some question with respect to the sufficiency of capital supply in the light of the prospective stepped-up requirements. In analyzing this question a few aspects are of special importance.

The first is the currently favorable financial position of business. Even after recent tax increases, profit levels are relatively high and dividend policies still generally conservative. Further tax increases could, of course, serve to limit the availability of funds retained from operations.

The long-term debt and the working capital structure of business do not appear to be deterrents to the raising of additional funds, with the equity cushion substantial, carrying charges on the debt low in historical perspective, and current assets high in relation to current liabilities.

Plant and equipment outlook

Undoubtedly plant and equipment outlays will constitute a major demand for funds in the period ahead. The anticipated expansion of facilities in 1951 has already been pointed out. It is uncertain, however, to what extent this expansion will involve added demand for private funds. Increased outlays in defense and related industries will undoubtedly require additional funds, but many of these investments may in large part be directly financed by the Federal Government as was the case in World War II.

In addition, provision has already been made to stimulate defense-related facilities expansion by permitting business, under the accelerated amortization program, to charge off a larger than normal amount of new facilities to current operating revenues, thus in effect reducing the need for external long-term financing. With respect to nondefense facilities expansion, it is not certain that all of the anticipated expansion for 1951 will be forthcoming since growing shortages of materials and manpower may force reductions in outlays below anticipated rates.

Working capital outlook

It is likely moreover that the demand for new working capital will be reduced from recent levels, once the defense program is well under way. Although additional inventories may be required to fill the defense production pipelines, Government limitation orders on inventory accumulation and shortages in civilian supplies will tend to restrict expansion in nondefense areas.

With respect to customer financing, steps have already been taken to curtail the extension of credit by business. Controls on consumer borrowing may be expected not only to dampen the direct extension of credit to consumers but also to limit indirect financing. In this latter connection, the recent action of the Board of Governors of the Federal Reserve System in raising bank reserve requirements serves to some extent as a deterrent to general bank lending.

Finally it may be noted the current liquid position of business is such that operating rates might be considerably increased before additional financing is required to increase holdings of liquid resources.

Increased flow of funds

In the period ahead the tendencies will probably be toward an increased supply of private funds for investment. It would appear that consumer spending may not keep pace with the rise of disposable incomes resulting in increased consumer savings.

At the same time, some of the investment media now available for individual and institutional savings will not be available. In particular, the supply of mortgages for institutional investors will be substantially lower.

In view of these considerations—restricted investment opportunities in the face of increased availability of investment funds—it is quite likely that under the full impact of the defense program there will be an abundance rather than a shortage of private capital funds. Thus, as was the case in the last war, the tendencies may well be toward substantially increased liquidity and downward pressures on the cost of investment funds.

National Income and Corporate Profits in the Third Quarter of 1950

[*Continued from p. 6*]

Third-Quarter Profits by Industry

Nearly all of the broad industrial groups for which data are presented in the accompanying table participated in the third-quarter rise in profits, with the general pattern of increase similar to that in the previous quarter. Transportation earnings were up three-fifths from the second to third quarter, the bulk of the increase occurring in railroads. With the heavy overhead cost structure that prevails in the railroad industry, a further appreciable rise in revenues (13 percent) led to an expansion of four-fifths in the earlier low railroad earnings. Mining—up one-third—registered a better-than-average increase. The rise of 28 percent in manufacturing was slightly higher than the all-industry total.

The small decline in profits reported for the communications and public utilities division was seasonal; on a seasonally adjusted basis profits in this sector rose moderately. Profits in wholesale and retail trade, which dominate the remaining group of industries, were up substantially—although less than average—from the second quarter.

Profits within manufacturing

All manufacturing subdivisions increased their earnings in the third quarter of 1950. The largest increases occurred in the nondurable-goods sector, where price increases in response to heightened demand were relatively large. The margin of profits on sales increased sharply—from 8.2 to 9.9 percent.

[*Continued on p. 24*]